No. 12846

United States Court of Appeals

For the Ninth Circuit

CHARLES D. BRONSON, JR.,

Appellant,

vs.

HUGH EARLE, Collector of Internal Revenue for the District of Oregon and United States of America,

Appellees.

Appeal from the United States District Court for the District of Oregon

REPLY BRIEF OF APPELLANT

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REPLY BRIEF OF APPELLANT

I.

THE RECORD FAILS TO SUPPORT A DETERMINATION THAT PARKDALE LUMBER COMPANY WAS NOT A BONAFIDE PARTNERSHIP FOR TAX PURPOSES.

"There is no special concept of partnership for tax purposes as distinguished from general law purposes." *Culbertson vs. Commissioner,* 337 U. S. 733. (Appellant's Op. Br. p. 14.)

If the Supreme Court meant anything by its repition of this fact in the Culbertson decision, the Appellee's brief fails.

The position of Appellee is that this was not a bonafide partnership because one of the partners did not contribute to the partnership according to some standard set up in their judgment.

That is not the holding in the Culbertson case, but quite to the contrary.

The Culbertson case holds that it is the judgment of the parties and not the judgment of the Commissioner or outsiders which determine the bonafides of a transaction, and if the parties themselves intended to form a partnership for the conduct of a business, it is valid for tax purposes as well as general law purposes. (Appellant's Op. Br. p. 19 and 21.)

To hold that the partnership in question was not valid for tax purposes would render the repeti-

tion of this principle in the Culbertson case absolutely meaningless unless it could be said that there was obviously no intent by the parties themselves to form a partnership (in this case four parties).

The facts of this case do not so indicate. It is not the case of an existing business where a family member is "brought into" the business for the sole purposes of reducing the tax to the party conducting said business. It is this latter scheme that the Commissioner is entitled to attack but certainly not the former.

Appellee's attempt to distinguish the case of *Twin Oaks Co.* vs. *Commissioner,* 183 F. 2d 1385 (CA9) on the ground that the court found complete good faith in the formation of that partnership and that it was not formed for tax avoidance purposes (Appellee's Br. p. 16).

Where is that good faith lacking in the present case?

The partnership was not formed for tax avoidance purposes, because there was no taxable income to avoid when the partnership was formed.

Appellees carefully avoid discussion of this in their brief but attempt to avoid the effects of the *Twin Oaks Co.* case by saying there was no subterfuge found in that case. There is none in the present case.

Is there any subterfuge when parties before starting the business operation cause the articles of partnership to be publicly recorded in the county where the operation is to be carried on and likewise with the corporation commissioner?

By what fact do they claim subterfuge and what place has such an unsupported inuendo in a brief before this court?

It has been *repeatedly held* and *particularly held* in the *Twin Oaks Co.* case that a person or group of persons has the right to choose any form or entity of doing business.

Appellant takes no issue with appellee concerning the cases cited by them holding that a mere paper transaction where there is an *existing* business for the *sole purpose* of minimizing taxes may be inquired into concerning the actuality of such an arrangement.

That was the rule stated in the cases cited by appellees prior to the Culbertson decision. (Appellee's Br. p. 14.)

Commissioner vs. Tower, 327 U. S. 280;
Burnet vs. Leminger, 285 U. S. 136;
Lucas vs. Earl, 281 U. S. 111;
Wilson vs. Commissioner, 111 F. 2nd 556;
Grant vs. Commissioner, 150 F. 2d 915;
Earp vs. Jones, 131 F. 2d 292;
Nordling vs. Commissioner, 166 F. 2d 703;
Bloomfield Ranch vs. Com., 167 F. 2d 581.

Some of the cases cited above are not in point factually. However the principle has been established and is conceded, but that principle is not applicable here.

It probably is also the rule after the Culbertson decision, although considerable doubt has been cast on the prior decisions in view of the fact that the dissenting opinions in the Culbertson case treated that holding as a complete reversal of *Commissioner vs. Tower.*

Yiannias v. *Commissioner,* 180 F. 2d 115.

The fact that the circumstances of this case are directly contrary to the facts of the typical tax avoidance cases leaves both appellant and appellee in reliance on the same propositions as set forth in Culbertson and subsequent decisions.

If the taxpayer here had been operating an *existing* business and had "brought his wife into" that business without in any way changing the operation, the decisions relied upon by appellee would be applicable.

However, we have not an existing but a new business: not a continuous management or control, but a new management and control of four individuals: not a continuity of income but no income at all at its inception; not a subterfuge but a new business enterprise with full disclosure of the parties and their interests, not an existing capital contribution but four capital contributions; not a continuity of a limited or general liability, but separate and distinct limitations and creation of liabilities. These are the factual distinctions relied upon by appellant.

The only case cited by appellees in their brief decided since the Culbertson decision was *Yiannias vs. Commissioner,* 180 F. 2d 115.

This case involved the attempted paper transfer to taxpayer's wife of the taxpayer's total interest in his business. The lessor of the business property

refused to recognize the taxpayer's wife as Lessee. One of the partners in that existing business accepted her as a partner conditioned on the fact that the taxpayer would continue in the business and that no change in its operation would result therefrom. Taxpayer's wife was not liable for rents, insurance, taxes or any other liability.

The court said:

> "If it could be held that this assignment as between the parties had the effect of divesting petitioner of his rights or liabilities arising therefrom it would not necessarily substitute petitioner's wife as a member of the association or partnership, producing the income. There was no new agreement or association — the partnership or association was run exactly as before the assignment: — the consent of Maclay to withdrawal of petitioner was with the understanding that the partnership would run exactly as before without any real change. The wife had no contact with her alleged associates."

That case is the typical tax avoidance arrangement to which we have referred and is changed from the typical situation only in the fact that the husband attempted (but did not perfect) a complete divesture of his interest in the partnership.

Appellees state that cases cited by appellant (Appellee's Br. p. 14).

> Cooke vs. Glenn, 78 F. Sup. 519, 177 F. 2d 201;
> Funai v. Commissioner, 181 F. 2d 890;
> John Denning & Co. vs. Commissioner, 180 F. 2d 288;
> Vaughn vs. Carey, 88 F. Supp. 967.

which cases incidentally are all cases decided after *Culbertson* vs. *Commissioner,* are distinguishable by the fact that the court found capital, services or both were contributed by the wife.

Before showing that the facts of those cases and only those cases are controlling in the present case, we should point out that the capital and services test were definitely overruled as exclusive tests in the Culbertson decisions where the Supreme Court said: "That is the vice in the tests adopted by the tax Court."

Appellant points out that *John Denning & Co.* vs. *Commissioner* was not cited in appellant's brief in connection with the Parkdale transaction and is not factually applicable; *Funai* v. *Commissioner* was cited for the proposition that it is the right to receive income and not the exercise of that right

which is controlling and appellant does not contend that the facts in that case are controlling. *Vaughn* vs. *Carey* is cited by appellant for the proposition that the choosing of a particular business entity whether for tax purposes or otherwise is entirely proper. However, since *Appellees state* that *Vaughn* v. *Carey* and *Cooke* vs. *Glen* are decided on a finding that capital of the business was contributed, it should be pointed out that the capital in *Cooke* vs. *Glen* from the wife originated with the husband, (Appellant's Br. p. 29). When the court said, "Although the capital contribution of Elva Cooke to Broadway Chevrolet originated with her husband, V. V. Cooke, the amount borrowed was contributed to a *new venture* in the same proportions as V. V. Cooke, Almond Cooke and Jennings Cooke, the other partners, and in that proportion Elva Cooke is liable for Federal income taxes attributable to her one-fourth interest. And that in *Vaughn* vs. *Carey,* the wife had, prior to the formation of the partnership, transferred her stock in an unrelated corporation to her husband and that the proceeds of the sale of that stock later provided the capital for the partnership.

If counsel for appellees now concede that the findings of these cases are correct as to capital and services, we should then point out that the capital and services performed in those cases were no greater than in the present case, and a reversal on those authorities is indicated.

It was held in *Vaughn* v. *Carey* that Mr. Ramsey, one of the partners was the *only* partner actively engaged in running the business on a day to day basis. He was the general manager. Mr. Vaughn was president and general manager of another business, and Mrs. Ramsey and Mrs. Vaughn both had children at home. Mr. Vaughn and Mrs. Vaughn and Mrs. Ramsey would meet occasionally, however, to discuss the partnership business. In addition there was testimony of a third party that the wives did not attend meetings and knew nothing of the business. As to "services" in *Cooke* vs. *Glen* the partnership agreement placed the management in one partner and the court specifically states that no physical services were performed by the wives of the other partners.

Since appellant failed to cite this case of *Vaughn* vs. *Carey* on the general applicability of facts to

the present case in his opening brief and since the facts are almost identical with the present facts, appellant now cites this case along with *Cooke* vs. *Glen* to the court as general authority for appellant's position.

In both of the cases last above referred to, there were four partners, capital originating with the husband, a complete lack of physical services to the partnership, both cases were decided after Culbertson, both cases were cases of a new business venture and are factually the only and most closely analagous cases to the facts of this case found and cited by either appellant or appellee.

The court in the *Vaughn* vs. *Carey* case stated:

> "If these two plaintiffs previously had been engaged in an exceedingly profitable enterprise and in order to avoid higher tax brackets brough their wives together with each other into nominal partnership with no genuine participating interest in the wives, I could see some basis for adjusting of income, but here these parties were engaged in a new and untried venture at the inception of which there was no assurance whatever that here would be any profit or tax liability."
>
> "This seems to me, well illustrates the court's position that there could have been no purpose here, and I hold that there was no such purpose

of a device for avoiding or saving taxes such as is claimed by the government."

Appellees state that the partnership served no business purpose.

Appellant contends however, that the business purpose referred to in the Culbertson decision is that of the ordinary definition of a partnership "to enter into a business for profit."

Such a "business purpose" has no relationship to the business entity chosen for the conduct of a business.

If two or more persons join together for the purpose of conducting a business for profit that is sufficient to form a partnership.

Could it be contended that a corporation is invalid merely because that form is selected to protect its owners, from liability or for any other reason. The selection of this form of enterprise would serve no business purpose in the light contended by appellees, for a business could be operated just as effectively as an association, as a trust, as a partnership, or as a proprietorship. If persons choose to do business as a trust or a corporation, the form of business entity is not invalid for tax

purposes, merely because the same business could be operated in some other form. It is not the mere whim of the Commissioner that determines taxability of an entity.

The case of *Quon* vs. *Commisioner* (165 F. 2d 215) cited by appellees in support of their statement was a case involving a partnership of citizens some of whom held their interests in effect as trustees for non-citizen relatives in order to prevent the assets of the aliens from being seized or frozen in time of war.

The attempt to apply that situation to the present case is obviously erroneous. The court held that the attempt to prevent freezing of funds was not a business reason in itself where it was for the protection of property unrelated to any business purpose. Here, however, taxpayer had another business and other partners that it was necessary to protect and hence, if this is applicable at all, there was a definite business reason for choosing the form of enterprise that was selected although it was not appellant alone who selected the business entity but three other parties.

In the Quon case the court states that the limited partners were included as mere depositories for a purpose other than one connoting a true partnership. While here, on the contrary, we have a purpose which is consistent with, and only with, the intent to form a valid partnership, and is an additional reason for taxpayer's wife as a partner. The Quon case was again, of course, decided prior to the Culbertson case.

Appellees state (Br. p. 13-14) that no stability was added to the partnership by the wife being a general partner. In the first place a partnership is stabilized by the inclusion of any morally and financially responsible person for there is one additional party to whom creditors may look for payment of their obligations. Appellees state factually that the wife of appellant had no assets. Surely counsel for plaintiff are not so naive as to believe that the joint ownership of a substantial amount of securities, a substantial bank account and real property held as tenants by the entireties are not assets readily available to creditors of the partnership where the wife is a general partner.

There being no authority to the contrary, the matter of the Parkdale income should be decided

on the current principles set forth in the following cases:

> Culbertson vs. Commissioner, 337 U. S. 733;
> Vaughn vs. Carey, 88 F. Sup. 967;
> Cooke vs. Glen, 78 F. Sup. p 619 A, 177 F. 2d 201.

II.

THE RECORD FAILS TO SUPPORT A DETERMINATION THAT INCOME OF ASHBAUGH WOOD SHINGLE AND SHAKES WAS INCOME OF TAXPAYER ASSIGNED TO HIS WIFE.

The question to be decided in the matter of Ashbaugh Shingles and Shakes is "who is taxable on the income of that partnership reported by taxpayer's wife?"

We do not intend to get into a discussion of matter exteraneous to the issue of taxation of income. It is sufficient to state that the legality of the Ashbaugh partnership is admitted by Appellants (Deposition of Morgan Stark, p. 36, Appellant's Br. p. 26) where Mr. Winter states: "We are not questioning the legality of your arrangements with the wives of Mr. Roles and Mrs. Bronson. You have a perfect right to enter into an agreement with them."

This court (*Twin Oaks Co.* vs. *Commissioner*) as well as other courts have repeatedly held that where a taxpayer has divested himself of or does not have any right in the management or ownership of, or income from a business entity, he may not be taxed on the income therefrom.

The earnings of this partnership came from, and exclusively from, the sale of shingles by that partnership concern in the Los Angeles area.

Appellant had no right to control that operation or any part thereof. He made no capital contribution, he had no right to the management or control nor had he ever had such a right, he neither received nor had the right to receive any of its income. The corporation of which he was a partial owner had as a customer Louis B. Ashbaugh who continued as a customer until he sold his interest to Beverly Roofing Company, a transaction with which taxpayer had no concern. Warrenton Shingle Company continued to supply shingles to Ashbaugh Wood Shingles until that company failed to make payment for merchandise shipped at which time its supply was terminated by the corporation.

The cases cited by appellees are not applicable and are discussed separately as follows:

The case of *Nordling* vs. *Commissioner,* (166 F. 2d 703) cited by appellants (Br. 23) was a case where one brother purchased the interest of another brother in an existing business and included the wife's name on a part of the papers involved in the transfer of the one-half interest. The case, decided before Culbertson, is a typical tax avoidance arrangement and has no relation to the facts concerning Ashbaugh income.

The case of *Yiannias* vs. *Commissioner* (180 F. 2d 115) which has been previously discussed was again a typical tax avoidance re-arrangement of an existing business where the wife assumed no obligation and received merely the right to receive the income where the husband continued to manage the business and be responsible for the obligation under an agreement with another partner to so do.

Semmler vs. *Commisioner,* 173 F. 2d 218 is a very brief opinion holding that in an existing business where a father made a gift of partnership interest to four minor sons and retained complete control of the business and received substantial eco-

nomic benefits, the income was properly taxable to him. Again this was the typical tax avoidance rearrangement.

Anderson vs. *Commissioner,* 164 F. 2d 810 was a case of gifts of corporate stock to family members with dissolution and a new partnership or right to create a partnership formed. It was held the attempted gifts were invalid for tax purposes. This was decided before the Culbertson case and in view of *Twin Oaks Co.* vs. *Commissioner* might be held to the contrary now.

In this case however the court indicated that if the passage of title was accomplished by a shift of economic benefits direct and indirect the same would be valid.

Later decisions have cast considerable doubt on the effects of this decision and *Epps* vs. *Commission*: See

> *Greenberger* v. *Commissioner,* 7 TCM 346;
> *Apt.* vs. *Birmingham,* 89 F. Sup. 361;
> *Willard* vs. *U. S.,* 89 F. Sup. 977;
> Twin Oaks Co. vs. Commissioner, 183 Fed. 218.

Epps vs. *Commissioner,* 164 F. 2d 481, in a brief opinion, held that where gifts of capital were made

to family members, it was a continuation of the corporate business with no apparent change in management.

The case of *Walker* vs. *Commissioner* (1946) (P.H.T.C. Memo, Par. 36, 159) was decided under the case of *Commissioner* v. *Tower* — on the principles of capital and services, later overruled in *Culbertson* vs. *Commissioner*. Here also there was a retention of control of the business by the donor.

While appellees state in their brief (p. 23) that taxpayer's argument is unsound "that an individual can not be taxed on profits earned from a property which he neither owned or controls" yet THEY FAIL TO CITE A SINGLE CASE *which has held to the contrary*. In each of the cases cited by appellees, taxpayers retained the control of the management and the income in an existing business.

The principle is now firmly established that where a person has no interest, right of management or control, nor right to receive the profits of a partnership business, the income therefrom can not be taxed to him.

Under the facts as to Ashbaugh, there was again no reduction (as stated by Appellee's (Br. 23)) of

income since at the formation there was no income to reduce.

The matter of the Ashbaugh income should be decided according to the current principles of:

Twin Oaks Co. v. Commissioner, 183 F. 2d 385;
John L. Denning Co. vs. Commissioner, 180 F. 2d 288;
Bein, 14 TC 1144;
Vance, 14 TC 1168.

APPELLANT'S REPLY TO APPELLEES CONCLUSION CONCERNING FINDINGS OF FACT AND CONCLUSIONS OF LAW

The findings of fact and conclusions of law of the District Court should be set aside.

Where the evidence as applied to the law fails to support the findings of fact and conclusions of law, the case must be reversed on appeal.

There are no disputed facts in this record. All of the testimony is from the partners of the partnership, and by Mr. Martin supplemented by the deposition of Morgan Stark as to the income of Ashbaugh Wood Shingles and Shakes. No evidence was introduced by appellees.

The documentary evidence is unimpeached and no rebuttal testimony was offered on the trial.

The evidence permits of only one conclusion that the parties intended to form the Parkdale partnership and they fulfilled that intent. There was no basis on which Ashbaugh Shingle income can be allocated to taxpayer for tax purposes or any other purpose.

Note: Attention is called to page 12 of Appellee's brief in which appellee states — "The theory of a gift was advanced as an inference for the first time in taxpayer's brief on appeal." Since the appellees have seen fit to go outside the record in making this statement, we feel free to state to the court that the matter of gift capital was argued to the trial court after the close of plaintiff's case and by objection to findings and has consistently been relied upon by appellant and not by inference but by direct assertion occupying pages 26, 27, 28 and 29 of appellant's brief.

CONCLUSION

The case should be reversed and a decision rendered in favor of appellant both as to Parkdale and Ashbaugh income.

Respectfully submitted,

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